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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

COMMISSIONERS

2008 JAN -3 P 4: 05

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MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
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AZ CORP COMMISSION
DOCKET CONTROL

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MM

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS SUN CITY
WASTEWATER AND SUN CITY WEST
WASTEWATER DISTRICT.

DOCKET NO. W-01303A-07-0209

**NOTICE OF FILING TESTIMONY
SUMMARIES**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony Summaries of Steven P. Irvine (Utilities Division); Alexander Igwe (Utilities Division); and Dorothy Hains (Utilities Division) in the above-referenced matter.

RESPECTFULLY SUBMITTED this 3rd day of January, 2008.

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**EXECUTIVE SUMMARY OF STEVEN P. IRVINE
ARIZONA-AMERICAN WATER COMPANY
SUN CITY WATER DISTRICT
DOCKET NO. W-01303A-07-0209**

Surrebuttal cost of capital

The Surrebuttal Testimony of Staff witness Steven P. Irvine addresses the following issues:

Capital Structure – Staff recommends that the Arizona Corporation Commission (“Commission”) adopt a capital structure for Arizona-American Water Company (“Arizona American” or “Company”) for this proceeding consisting of 61.0 percent debt and 39.0 percent equity.

Cost of Equity – Staff’s 10.8 percent estimated return on equity (“ROE”) for the Company is based on cost of equity estimates for the sample companies ranging from 9.1 percent using the discounted cash flow method (“DCF”) to 10.5 percent using the capital asset pricing model (“CAPM”). Staff’s ROE recommendation includes a 1.0 percent upward adjustment due to the higher financial risk reflected in Arizona American’s capital structure in relation to that of the sample companies.

Cost of Debt – Staff recommends that the Commission adopt a 5.5 percent cost of debt.

Overall Rate of Return – Staff recommends that the Commission adopt an overall rate of return (“ROR”) of 7.6 percent.

Mr. Broderick’s Testimony – The Commission should reject the 7.7 percent Cost of Capital proposed by Arizona American as it is appropriate to include short-term debt in the capital structure. The Company’s position that there is a lack of association between short-term debt and rate base is inconsistent with modern financial theory. Each of the elements of the capital structure (capital leases, long-term debt, short-term debt, preferred stock, and common stock) together provide a single pool or source of funds that are available for all uses of funds.

Direct rate design

The testimony of Mr. Steven P. Irvine presents Staff’s recommended rate design.

The present rate design is based on minimum monthly charges that generally increase by meter size. For the most part, customers are distinguished by meter size of which there are seven currently serving residential and commercial customers. In addition to the monthly minimum charge residential and commercial customers pay a tiered commodity rate. The 5/8-inch and 3/4-inch residential classes include a three-

tiered commodity rate. Each of the other residential and commercial classes has two-tiered commodity rates. Currently no gallons are included in the minimum charges. Irrigation, Private Fire and Public Interruptible classes pay a monthly minimum and a flat rate rather than tiered commodity rate. Central Arizona Project water is sold with no minimum charge and a flat commodity rate.

The Company proposes to keep the same rate structure for all classes. The Company's proposed rates spread the proposed increase in revenue across all the customer classes. The increase is accomplished by increasing monthly usage charges and commodity charges. No change is proposed by the Company for miscellaneous service charges.

Staff recommends a comparable rate structure to that currently in place. The exception is that many of the thresholds are reduced to encourage more efficient use of water. Staff recommends a three-tier inverted block rate structure for the residential 5/8-inch and 3/4-inch customer classes with break-over points at 3,000 gallons and at 10,000 gallons. Staff recommends a two-tier inverted block rate structure for each of the commercial meter sizes and for each of the residential meters that are larger than 3/4-inch. Staff's methodology for determination of monthly minimum charges is based on the volumetric capacity of each class's meter size and generally increases proportionally to the capacity for each meter size. Staff's recommended rate design would generate Staff's recommended revenue requirement of \$9,602,228, including \$9,492,185 from metered water sales. Metered water revenue of \$9,492,185 represents a 25 percent increase over the Test Year metered water revenue. The typical 5/8-inch meter residential bill with median use of 6,431 gallons would increase by \$2.84, or 23.89 percent, from \$11.88 to \$14.72.

Surrebuttal rate design

The Surrebuttal Testimony of Staff witness Steve Irvine addresses the following issues:

Response to the Rebuttal Testimony of Applicant's witness Mr. Thomas M. Broderick

Mr. Broderick's Rebuttal Testimony describes that the Company accepts Staff's recommendation to reduce the break-over points as per schedule SPI-1. No other comments appear to be made regarding Staff's recommended rate design. No discussion or objections relative to rate design appear to be made that would call for a response through Surrebuttal Testimony.

Staff's updated rate design

Staff's recommend rate design would generate Staff's recommended \$9,632,551 revenue requirement, a 25 percent increase over the test year. The typical 5/8-inch meter residential bill with median use of 6,431 gallons would increase by \$2.89, or 24.29 percent, from \$11.88 to \$14.77.

**EXECUTIVE SUMMARY OF ALEXANDER IGWE
ARIZONA-AMERICAN WATER COMPANY
SUN CITY WATER DISTRICT
DOCKET NO. W-01303A-07-0209**

The Testimony of Staff witness Alexander Igwe addresses the following issues:

The Company has adopted Staff's recommended rate base of \$25,295,922.

The Company has accepted all of Staff's recommended adjustments to Operating Income. Staff recommends a Revenue Requirement of \$9,632,551. The only difference between Staff and the Company on Revenue Requirement, results from difference in Capital Structure. However, Staff would note its objection to the Company's suggestion that it could seek recovery of unamortized rate case expense should it fill for a rate increase prior to 2012. The Company's contention is inconsistent with sound rate making principles.

As it relates to the Public Safety projects, Staff would caution the Company on the escalation of its proposed project costs. It has increased from \$3.1 to \$4.9 million, and now \$5.1 million. As stated in Staff's prior testimonies, the project costs will be scrutinized when it files for recovery.

**EXECUTIVE SUMMARY OF DOROTHY HAINS
ARIZONA-AMERICAN WATER COMPANY
SUN CITY WATER DISTRICT
DOCKET NO. W-01303A-07-0209**

The Testimony of Staff witness Dorothy Hains addresses the following issues:

Staff's Recommendations:

1. Staff recommends that the depreciation rates for Arizona American Company's Sun City District ("Sun City District") presented in Figure 6 by NARUC account be used for purposes of this proceeding and on a going forward basis. (See §J of report for discussion and details.).
2. Staff recommends the adoption of Sun City Water proposed Service Line and Meter Installation Charges. (See §K of report for discussion and details.)
3. If the Company's request to implement the Fire Flow Improvement surcharge is approved, Staff recommends that the surcharge be based on Staff's cost estimate of \$2,670,602. (See §K of report for discussion and details.).
4. Staff recommends that existing 3-inch fire hydrants be replaced by standard size fire hydrants when repairs to the 3-inch hydrants are needed and when it is economical for the Company to do so. (See §K of report for discussion and details.).
5. Staff recommends that the Company monitor the water system closely and take action to ensure the water loss remains 10 percent or less in the future. If the water loss at any time before the next rate case is greater than 10 percent, the Company shall come up with a plan to reduce water loss to less than 10 percent, or prepare a report containing a detailed analysis and explanation demonstrating why a water loss reduction to 10 percent or less is not feasible or cost effective. Such a report shall be docketed in this case. (See §H of report for discussion and details.).

Staff's Conclusions:

1. Maricopa County Environmental Services Department ("MCESD") has determined that this system is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4. (See §D for a discussion of the financing.)

2. Sun City Water is within the Phoenix Active Management Area and is in compliance with the Arizona Department of Water Resource ("ADWR") monitoring and reporting rules. (See §F of report for discussion and details.)
3. Sun City Water has 10 percent water loss which is within acceptable limits. (See §H of report for discussion and details.)
4. Sun City Water has an approved cross connection tariff. (See §K of report for discussion and details.)
5. Staff considers the reported water testing expenses and the estimated water testing costs of \$9,619 for the Sun City Water District reasonable. (See §G of report for discussion and details.)
6. Sun City Water District has adequate production and storage capacity. (See §B of report for discussion and details.)
7. Sun City Water District has an approved curtailment tariff. (See §K of report for discussion and details.)
8. \$19,085 of well drilling is not used and useful. (See §K of report for discussion and details.).

The Surrebuttal Testimony addresses the following issues:

1. Fire Hydrant Replacement Cost In Developed Areas
Since the fire hydrants that are to be replaced are located within the same construction areas as the lines, the restoration costs included for line replacement and repair should be adequate to cover fire hydrant installation as well. Staff still recommends its downward cost adjustment for fire hydrant installation of 0.41 million dollars. However, Staff has not made a determination of the capital improvements as "used and useful" at this time, but defers this determination until the Company files its next rate application.
2. Non-account Water
The water loss in the Company's Sun City System is at 10 percent which is acceptable. Staff does not recommend any specific reporting at this time. If the water loss at any time before the next rate case is greater than 10 percent, the Company shall come up with a plan to reduce water loss to less than 10 percent, or prepare a report containing a detailed analysis and explanation demonstrating why a water loss reduction to 10 percent or less is not feasible or cost effective. Staff has no objection to the Company suggested water usage form. Staff agrees with the Company that it use its annual report to track water loss, as long as water usage data is reported on an individual system basis in the Company's annual report.